

STATE OF IOWA
PROPERTY ASSESSMENT APPEAL BOARD

Coralville Hotel Real Estate, LLC,
Appellant,

v.

Johnson County Board of Review,
Appellee.

ORDER

**Docket No. 13-52-0108 &
14-52-0023
Parcel No. 0732451006**

On December 17, 2014, the above-captioned appeal came on for hearing before the Iowa Property Assessment Appeal Board. The appeal was conducted under Iowa Code section 441.37A(2)(a-b) and Iowa Administrative Code rules 701-71.21(1) et al. Attorney Deb Tharnish of Davis Brown Law Firm, Des Moines, represented Appellant Coralville Hotel Real Estate, LLC. Assistant Johnson County Attorney Andy Chappell represented the Johnson County Board of Review. The Appeal Board now having examined the entire record, heard the testimony, and being fully advised, finds:

Findings of Fact

The subject property is a hotel convention complex with two hotels operated as a Holiday Inn and Hampton Inn located at 1200 1st Avenue, Coralville, Iowa. According to the record, the Holiday Inn Hotel was built in 1974 and has 95 rooms and a restaurant. This hotel also has a meeting and banquet space and a small indoor pool shared with the Hampton Inn. The Hampton Inn was built in 1996 and has 115 rooms. It also includes a reception area, lobby area, office area, and an exercise room. (Exhibit 7, p. 5). The site is 7.225-acres and has 140,000 square feet of paved parking.

The property's 2013 assessment was \$8,115,400, allocated as \$2,202,900 in land value and \$5,912,500 in improvement value. Coralville Hotel protested the assessment to the Johnson

County Board of Review contending it was not equitable as compared with the assessments of other like property; it was assessed for more than authorized by law; and that there had been a change in value since the last assessment. Iowa Code sections 441.37(1)(a)(1), (2); 441.37(1)(b); & 441.35(2) (2013). The change in value claim essentially reasserted Coralville Hotel's assertion that the property was over-assessed. The Board of Review denied the petition.

The assessment did not change from 2013 to 2014 and Coralville protested the 2014 assessment on the ground that there has been a change in value since the last assessment. Iowa Code 441.37(1)(a)(2) (2014). The Board of Review denied the petition.

Coralville appealed both assessments to this Board. No evidence was submitted regarding an equity claim; and we will consider only the 2013 claim of over-assessment and 2014 claim of change in value. If Coralville Hotel fails to show a downward change in the value for 2014, the 2014 assessment may still be reduced if it proves its 2013 over-assessment claim. *See* § 428.4 (due to the biennial assessment cycle, any modification of the 2013 assessment will apply equally to the 2014 assessment).

Kineth Hospitality operates Coralville Hotel. Bruce Kineth, part owner and manager in Kineth Hospitality, testified in its behalf. Kineth Hospitality owns thirty-four hotels and manages another forty hotels located in thirteen states. The majority of these properties are located in the Midwest and approximately twenty-five are located in Iowa. Kineth has been in the hotel business throughout his career, and his experience includes buying, selling, renovating, and managing hotel properties.

Kineth explained the original improvements to the site were built in the mid-1970s. Over time, portions of the original improvements were removed and a new hotel, now the Hampton Inn, was built at the front of the property on the corner of I-80 and 1st Avenue. The

older remaining improvements were then renovated. Kinseth Hospitality converted the rear hotel into a Holiday Inn when it purchased the property. Because the Holiday Inn was built in the mid-70s, Kinseth notes it lacks some modern features found in newer hotels such as a more compact design. In his opinion it has “a lot of economic obsolescence.”

Kinseth also testified that while the Holiday Inn has performed reasonably well over the last ten years, due to the unusual setup of two competing hotels sharing some facilities, the Holiday Inn company is reluctant to continue the franchise. The Holiday Inn franchise is now set to expire in June 2015. Kinseth also testified that the Holiday Inn license agreement is personal to Coralville Hotel and would not likely continue with the property if it were sold, regardless of the length of franchise time remaining. He explained that Coralville Hotel cannot sell the Holiday Inn license and any purchaser of the property would need to find their own brand license which could affect the price that would be paid. He indicated they were currently searching for a new brand and are in discussions with Radisson.

Kinseth indicated the income and expenses in Frandson’s appraisal are the subject’s actual income and expenses for 2010 to 2013. (Exhibit 7, p. 52). He noted that a 4% reserves for replacement allowance is taken from the net operating income (NOI) and kept as an asset on the balance sheet, but that the income statement does not reflect a reserves for replacement allowance. He stated that reserves for replacements are used to pay for capital expenditures, which generally involves asset purchases in excess of \$1,000, and those assets are depreciated over time. Kinseth further testified to his opinion that an 8% capitalization rate is too low and that 10 to 12% is more reasonable for this property. He also stated that the Furniture, Fixtures, and Equipment (FF&E) on the property amount to approximately \$5000 per room, excluding common areas.

While Kinseth's testimony of the subject property provided background, he did not offer an opinion of market value for the property.

Coralville Hotel also submitted an appraisal from Ted Frandson of Frandson and Associates, LLC, Des Moines. (Exhibit 7). Frandson testified on Coralville Hotel's behalf at hearing.

Frandson valued the subject property for the 2013 and 2014 assessments as follows.

January 1, 2013	January 1, 2014
\$6,860,000	\$6,250,000

Frandson only completed an income approach to value for the subject property as of the assessment date. Frandson's income approach was completed using a Discounted Cash Flow analysis (DCF). A DCF is a procedure in which a discount rate is applied to a set of projected income streams and a reversion. APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 59 (5th ed.). "In many markets and for many property types, DCF analysis is the technique investors prefer. The proper application of DCF analysis identifies the market conditions *investors* are anticipating as of the date of value." APPRAISAL INSTITUTE, THE APPRAISAL OF REAL ESTATE 539 (14th ed.).

Frandson did not complete the cost approach to value the subject property because in his opinion its design and age would not render a reliable result. However, he completed the cost approach for determining a value of the FF&E. He concludes that the depreciated cost of the FF&E was \$1,018,000 as of January 1, 2013, and \$926,380 as of January 1, 2014.

While Frandson's appraisal included a sales comparison analysis, the analysis did not determine the subject property's value as of January 1, 2013 or 2014. Rather, the sales analysis was developed to determine a value *as of the date of reversion, or prospective value*, which is

sometime in January 2016. (Exhibit 7, p. 42). Frandson used sales of hotel properties in Iowa City, Omaha, and Rochester, from August 2010 to May 2013. He made customary adjustments for size, location, age, and condition, but also appears to have made market condition adjustments to reflect changes in market conditions going forward to January 1, 2016. Frandson concluded the reversionary value of the subject property to be \$38,000 per room, for a total value of \$7,980,000 including FF&E.

Frandson developed the income approach to value for two separate purposes. First, he determined a reversionary value as of January 2016 using the direct capitalization method. To do so, he projected occupancy rates, average daily rates (ADR), restaurant revenue, and expenses to determine a stabilized NOI. Frandson concluded a stabilized NOI of \$1,278,072, applied a capitalization rate of 15.58%, and concluded a reversionary value of \$8,203,000. Based on the sales and income approaches, Frandson reconciled the value of the reversion at \$8,000,000, as of January 2016. (Exhibit 7, p. 55).

Frandson also used the income approach to estimate to the property's market value prior to "completing the improvements necessary to secure a new franchise for the current Holiday Inn hotel," or approximately January 2016. He projects that prior to that time, occupancy and the ADR will remain above the projected stabilized level and expected revenues will be \$5,039,373 for each year from 2013 to 2015. He predicts stabilized annual operating expenses of approximately \$2.2 million. For 2015, however, he includes a \$2.5 million expense for the Property Improvement Plan (PIP) that must occur prior to another franchise taking over the Holiday Inn portion of the property. Upon concluding the projected NOI for 2013-2015, Frandson applied a discount rate to determine the present value of the future cash flows as of January 1, 2013, and January 1, 2014.

Frandsen then added his present value conclusions for both the future cash flows and the reversion value to reach his conclusions of value as of January 1, 2013, and 2014, including the subject's FF&E. After deducting the depreciated cost of the FF&E, Frandsen concluded the subject's real estate value was \$6,860,000 (rounded) as of January 1, 2013, and \$6,250,000 (rounded) as of January 1, 2014.

Frandsen did not develop the sales comparison approach as of the January 1, 2013 or January 1, 2014 assessment dates; nor did he suggest the property could not be valued by the sales comparison approach as of those dates.

County Assessor Bill Greazel testified for the Board of Review and provided a background of the property's assessment. He explained the assessment does not include a "reserve for replacement." In his opinion, a reserve for replacement may or may not happen to a property. Further, he has never seen a transfer of revenue to a new owner for reserves that were not expended and therefore he is not comfortable including it in the valuation model. Lastly, he believes the capitalization rate considers this, which reflects the return on and return of an investment. Therefore, in his opinion, if it were also considered in the income stream it would it would effectively result in a double dip.

Grezel also did not reduce the assessment for FF&E. He explained this is consistent with all of the assessments of hotels/motels in Johnson County. Grezel testified that of the last eight sales he has reviewed in the County approximately half have included FF&E. Because there is a wide-range of what is reported for FF&E, his office "normalizes" the process and considers it in the capitalization rate, which is also adjusted for age and desirability of a property. He indicated that if deductions were made for reserves for replacements and FF&E, the assessments would be "way too low" when properties sold. On cross-examination, however,

Greazel testified that the same 8% capitalization rate is applied to the majority of hotel properties unless they are really old, “on their last breath,” and “on life support.”

When questioned about considering future events, such as the loss of a hotel brand, Greazel explained that an assessment reflects the *preceding* twelve to twenty-four months to establish a value for a January 1 assessment. An assessment does not reflect what may or may not occur in the future; but if something subsequently occurred to affect an income stream, the next assessment would reflect that event.

The Board of Review also submitted a spreadsheet of six hotel sales that have occurred in Johnson County between 2010 and 2014. Greazel testified that his office uses the sale-price-per-room to evaluate equitability. The sale of the Motel 6 property appears to be an outlier and we give it no consideration. The per-room sales price of the remaining properties ranged from \$30,357 to \$38,889, with an average of \$35,842 and a median of \$37,103. Three of the sales reported FF&E or personal property included in the sale ranging from \$400,000 to \$800,000, or \$4678 to \$5825 per room. In contrast, the subject is assessed at \$38,645 per room.

The sales are unadjusted for differences compared to the subject property and ultimately we find it irrelevant in determining the fair market value of the property as of the assessment dates. However, the spreadsheet does show that sales of hotels have occurred in the County and would have been available for a sales comparison approach to value.

Finally, the record also includes a one-page income statement developed by the Assessor’s Office. It is a limited presentation of the income analysis that was given significant consideration in the determination of the assessed value. The statement calculates an annual effective gross income of approximately \$3.6 million and an NOI of \$939,767 for the property.

The total capitalization rate of 11.58% is applied to arrive at a market value of \$8,115,400 (rounded).

Greazel explained that someone in his office inputs the information into the form and then a value is calculated. Greazel was unable to explain some of the numbers on the form, such as the 70% calculation for the restaurant and beverage department. Additionally, the form indicates the property has 277 rooms, but Greazel acknowledged the correct number of rooms is 210. Although he acknowledged the number was wrong and he is not sure why, he asserts that if the income information from Frandon's appraisal were used in the analysis the value indication would be higher than the current assessment. Thus, Greazel justifies the assessment despite the reporting errors on the form based on the fact that the income information presented at this Board's hearing would result in a higher assessment if it had been used in his Office's analysis.

Conclusions of Law

The Appeal Board has jurisdiction of this matter under Iowa Code sections 421.1A and 441.37A (2011). This Board is an agency and the provisions of the Administrative Procedure Act apply to it. Iowa Code § 17A.2(1). This appeal is a contested case. § 441.37A(1)(b). The Appeal Board determines anew all questions arising before the Board of Review related to the liability of the property to assessment or the assessed amount. § 441.37A(3)(a). The Appeal Board considers only those grounds presented to or considered by the Board of Review. § 441.37A(1)(b). But new or additional evidence may be introduced. *Id.* The Appeal Board considers the record as a whole and all of the evidence regardless of who introduced it. § 441.37A(3)(a); *see also Hy-Vee, Inc. v. Employment Appeal Bd.*, 710 N.W.2d 1, 3 (Iowa 2005). There is no presumption that the assessed value is correct. § 441.37A(3)(a).

General Principles of Law Applicable to Assessment of Real Property

Generally, the burden of proof is on the taxpayer to prove one of the statutory grounds for protest by a preponderance of the evidence. § 441.21(3); *Compiano*, 771 N.W.2d at 396.

However, if the taxpayer

offers competent evidence by at least two disinterested witnesses that the market value of the property is less than the market value determined by the assessor, the burden of proof thereafter shall be upon the officials or person seeking to uphold such valuation to be assessed. *Id.*

“Evidence is competent under the statute when it complies with the statutory scheme for property valuation for tax assessment purposes.” *Compiano*, 771 N.W.2d at 398. In Iowa, property is assessed for taxation purposes following Iowa Code section 441.21. Iowa Code subsections 441.21(1)(a) and (1)(b) require property subject to taxation to be assessed at its actual value, or fair market value. *Soifer v. Floyd County Bd. of Review*, 759 N.W.2d 775, 778 (Iowa 2009).

“*Market value*” is defined as the fair and reasonable exchange in the year in which the property is listed and valued between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and each being familiar with all the facts relating to the particular property.

§ 441.21(1)(b). In determining market value, “[s]ales prices of the property or comparable property in normal transactions reflecting market value, and the probable availability or unavailability of persons interested in purchasing the property, shall be taken into consideration.” *Id.* The Iowa Supreme Court has stated that “our assessment statute and prior case law require that the assessor consider any factor that may affect market value.” *Boekeloo v. Bd. of Review of*

City of Clinton, 529 N.W.2d 275, 278 (Iowa 1995) (citing *Barlett & Co. Grain v. Bd. of Review*, 253 N.W.2d 86, 88 (Iowa 1997)).

The sales-comparison method is the preferred method for valuing property under Iowa law. *Compiano*, 771 N.W.2d at 398; *Soifer v. Floyd Cnty. Bd. of Review*, 759 N.W.2d 775, 779 (Iowa 2009); *Heritage Cablevision v. Bd. of Review of Mason City*, 457 N.W.2d 594, 597 (Iowa 1990). “[A]lternative methods to the comparable sales approach to valuation of property cannot be used when *adequate* evidence of comparable sales is available to *readily* establish market value by that method.” *Compiano*, 771 N.W.2d at 398 (emphasis added). “Thus, a witness must first establish that evidence of comparable sales was not available to establish market value under the comparable-sales approach before the other approaches to valuation become competent evidence in a tax assessment proceeding.” *Id.* (citing *Soifer*, 759 N.W.2d, at 782); *Carlson Co. v. Bd. of Review of Clinton*, 572 N.W.2d 146, 150 (Iowa 1997).

Finally, assessors are permitted to consider the use of property as a going concern in its valuation. *Riso v. Pottawattamie Cnty. Bd. of Review*, 362 N.W.2d 513, 517 (Iowa 1985). When an assessor values property as a going concern, “he is merely following the rule that he must consider conditions as they are.” *Soifer*, 759 N.W.2d at 788 (quoting *Maytag Co. v. Partridge*, 210 N.W.2d 584, 590 (Iowa 1973)). The assessor is “recognizing the effect of the use upon the value of the property itself. He is not adding on separate items for good will, patents, or personnel.” *Id.*

Claim of Over-Assessment

To prevail on a claim that an assessment is for more than authorized by section 441.21(1), the law requires two showings. *Heritage Cablevision v. Bd. of Review of City of Mason City*, 457 N.W.2d 594, 597 (Iowa 1990). First, the record must show the property is over assessed; and

second, what the fair market value of the property should be. *Id.*; *Boekeloo*, 529 N.W.2d at 276-277. If PAAB “determines the grounds of protest have been established, it must then determine the value or correct assessment of the property.” *Compiano v. Polk Cnty. Bd. of Review*, 771 N.W.2d 392, 397 (Iowa 2009). Here, PAAB “makes its independent determination of the value based on all the evidence.” *Id.*

Analysis

The record contains two opinions of the subject property’s fair market value, Frandson’s appraisal and the assessment.

Frandson’s Appraisal

Frandson’s appraisal attempts to capture the impact of the loss of the Holiday Inn franchise on the property’s January 1, 2013 and 2014 fair market value. However, because we find flaws in Frandson’s methodology, we do not believe his final conclusion of value is a reliable reflection of the property’s fair market value as of those dates.

First, in developing his sales approach to conclude the subject’s reversionary value as of January 1, 2016, Frandson made market condition adjustments that vary from 5 to 15%. In doing so, Frandson is making projections about future market conditions. Likewise, his income approach to determine the reversionary value by concluding the subject property’s stabilized NOI is also based on projections about the future income and expenses of the subject property. While the actual income of the property may be some evidence of the property’s value, we note that standard assessment practice utilizes market data, not actual income and expenses, to value an income-producing property. *See Merle Hay Mall v. City of Des Moines Bd. of Review*, 564 N.W.2d 419, 423 (Iowa 1997) (approving of assessor’s use of objective rental income, not actual lease income, to establish valuation of leased mall space.). Use of actual income and expense

data runs the risk of either undervaluing or overvaluing a property. Further, while it may be appropriate to give some consideration to the expected loss of the Holiday Inn flag, we do not believe Iowa statutory law or case law contemplates the valuation of the property based on unsupported, projected future market conditions.

Second, in approaching his discounted cash flow analysis to value the subject for years 2013-2015, Frandson includes a \$2.5 million expense in 2015 for the Property Improvement Plan (PIP) which subsequently causes a projected negative NOI for that year. This ultimately reduces the present value of the projected future cash flows and reduces his final value conclusion.

The PIP is primarily a capital improvement project. Kinseth testified that capital improvement projects are generally not expensed in a single-year, but are depreciated on the owner's balance sheet. As a result, we question Frandson's treatment of the PIP in his appraisal, and we believe his methodology artificially lowers the value arrived at in his discounted cash flow analysis.

We add that Frandson also appears to give no consideration to the positive impact the \$2.5 million PIP could have on the subject property's fair market value. The testimony demonstrated the PIP is necessary to attract and retain a new long-term franchise. In our view, the physical improvements made to garner a new franchise as well as the existence of the long-term franchise agreement may have a positive impact on the property's fair market value in much the same way as with the impending loss of a franchise may have a negative impact on its value.

Lastly, we note the statutory preference for valuing property using the sales comparison approach. § 441.21(1). Although Frandson utilized the sales comparison approach to value the subject property's January 1, 2016, reversionary interest, he did not use the sales comparison

approach to develop a conclusion of value as of the relevant dates of this appeal. Given the sales provided by both parties, it appears the subject property's value could be readily established by that method, as well as account for any impact the loss of the franchise may have on the subject property's fair market value.

Based on the foregoing, we conclude that Frandson's appraisal is not a reliable and credible valuation of the subject property's fair market value for assessment purposes as of January 1, 2013, or January 1, 2014.

The Assessment

Coralville Hotel was critical of the assessment's failure to give consideration to the impending loss of the Holiday Inn franchise. We find the impending loss of the franchise should be a factor, among many, that is considered in determining the market value of this property. However, it is Coralville Hotel's burden to reliably demonstrate the affect the franchise loss has on the market value as of the relevant assessment dates. § 441.21(3). Because we find Coralville Hotel failed to do so, we cannot modify the assessment on that basis.

However, Coralville Hotel also questioned the assessment's inclusion of FF&E existing on the property and lack of reserves for replacements allowance. Although Greazel testified that his office considers FF&E and reserves for replacement within the capitalization rate in the income approach to value; he did not identify with any specificity the affect they ultimately have on the 8% capitalization rate applied to the subject. Further, we find his testimony that he adjusts the capitalization rate based on the age and desirability is somewhat contradicted by the fact that he applies the same 8% capitalization rate to the majority of hotel properties in the jurisdiction, unless they are "on their last breath" and "on life support."

Therefore, we find that the assessment should be modified to specifically account for FF&E existing on the property. Kinseth testified that, at a minimum, the FF&E amounted to approximately \$5000 per room. This is consistent with the sales data provided by the Board of Review that showed that FF&E on three sold properties ranged from approximately \$4600 to \$5800 per-room. This is also consistent with Frandson's calculation of the depreciated replacement cost of FF&E on the property \$1,018,000 as of January 1, 2013, and \$926,380 as of January 1, 2014.

We decline, however, to make any modification for reserves and replacements. The reserves and replacements allowance is ultimately a product of the revenue of the property, about which each party presented contradictory evidence. In fact, the total revenue calculations of the parties as of January 1, 2013, differed by approximately \$1.4 million. This impairs any reasonably accurate calculation of the appropriate reserves and replacement allowance.

In addition, we note that Coralville Hotel's income statements indicate it does not include a reserves for replacement allowance. (Exhibit 7, p. 52). Kinseth explained that a reserves for replacement account is, in fact, maintained and included on the business' balance sheet, but it was not submitted as evidence.

Claim of Downward Change in Value

"For even-numbered assessment years, when the property has not been reassessed" a taxpayer may challenge its assessment on the basis that there has been a change in value from the immediately preceding assessment year. Iowa Code § 441.37(1)(a)(2); *Equitable Life Ins. Co. v. Bd. of Review of Des Moines*, 252 N.W.2d 449 (Iowa 1977). "When this ground is relied upon, the protesting party shall show the decrease in value by comparing the market value of the property as of January 1 of the current assessment year and the actual value of the property for

the pervious assessment year.” *Id.*; see also *Equitable Life Ins. Co.*, 252 N.W.2d at 450 (holding for a taxpayer to be successful in its claim of change in value, the taxpayer must show a change in value from one year to the next; the beginning and final valuation). Essentially, it is not enough for a taxpayer to prove the last regular assessment was wrong; such a showing would be sufficient only in a year of regular assessment. *Id.* at 451.

Coralville Hotel relied on Frandson’s appraisal to determine a January 1, 2013, and January 1, 2014 value. However, based on the foregoing, we find Coralville Hotel has failed to show the subject property has suffered a downward change in value.

Conclusion

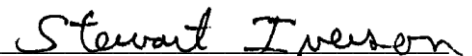
The Appeal Board finds the failure to account for FF&E in the current assessment results in the subject real estate’s over assessment. We determine that the assessment should be modified by removing Frandson’s depreciated cost of the FF&E. Therefore, we conclude the subject’s 2013 and 2014 assessments should be set at \$7,097,400.

THE APPEAL BOARD ORDERS the 2013 and 2014 assessments of the property owned by Coralville Hotel Real Estate, LLC located at 1200 1st Avenue, Coralville, Iowa, set by the Johnson County Board of Review, is modified as set forth herein.

Dated this 17th day of March, 2015.



Karen Oberman, Presiding Officer



Stewart Iverson, Board Chair



Jacqueline Rypma, Board Member

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